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IN THE

Supreme Court of the United States

OCTOBER TERM 1953

No. [redacted] 86 1

COLORADO INTERSTATE GAS COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

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FEDERAL POWER COMMISSION,
Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

On April 23, 1954, Respondent here, the Federal Power Commission, filed its Petition for a Writ of Certiorari (No. 710, October Term 1953) seeking review of that part of the judgment rendered by the United States Court of Appeals for the Tenth Circuit which was decided adversely to said Commission. Petitioner here will file a timely brief in opposition to granting the prayer of that petition.

Colorado Interstate Gas Company, Petitioner here, prays that this Court grant a Cross-Writ of Certiorari to review those portions of the judgment of the United States Court of Appeals which were adverse to it, and as are set forth by the statement of questions presented.

Opinions Below.

The opinion and order of the Federal Power Commission (R. 77-140) are reported in 95 P. U. R. (N. S.) 97. The original opinion of the Court of Appeals (R. 593-610) is reported at 209 F. 2d 717; its opinion on rehearing (R. 630-633) is reported at 209 F. 2d 732.

Jurisdiction.

The original judgment of the Court of Appeals was entered on October 29, 1953 (R. 610) after a review proceeding instituted by Petitioner pursuant to Section 19(b) of the Natural Gas Act (15 U. S. C. §717r(b)). Upon the granting of the Respondent Commission's petition for a rehearing this original judgment was vacated (R. 621). After said rehearing, the Court again entered judgment on January 25, 1954 (R. 633). By order of Mr. Justice Clark entered March 31, 1954 the time within which to file this cross-petition was extended to and including May 21, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. §1254(1) and §19 (b) of the Natural Gas Act.

Questions Presented.

1. In a proceeding before the Federal Power Commission under the Natural Gas Act resulting in a rate reduction, the Commission determined, over Petitioner's objections, to omit the initial or recommended decision of its available Hearing Examiner. The only expressed grounds for such omission were that the proceedings were in progress for a long time, and that the Commission lacked reparation authority. The lapse of time was found by the Commission not to be the fault of any party. The Staff of the Commission took an accusatory stand, and there were instances

where even the written record showed Commission Staff witnesses to be demeaning themselves in a manner which might have affected the weight or credibility to be attached to their evidence by the hearing officer who observed them. The question presented is whether upon these facts the Commission could omit the hearing officer's decision when the Administrative Procedure Act provides for such decision and permits its omission only if there is substantial evidence to support an agency finding "upon the record that due and timely execution of its functions imperatively and unavoidably so requires".

2. Whether the Commission in setting rates for the future allowed Petitioner a lawful rate of return which will enable it to operate successfully, maintain its financial integrity, attract capital, and compensate investors for risks assumed, if the return allowed is based solely upon the historical cost of all long-term debt money, actual cost of outstanding preferred stock, and the estimated capital cost of common stock equity, without evaluating or exercising its judgment to determine other factors such as inherent risks, the ability to attract capital in the future, or the ability to operate successfully within the allowed return.

Statutes Involved.

The pertinent provisions of the Natural Gas Act (§5(a)) and the Administrative Procedure Act (§§8 and 10) are set forth in the Appendix, *infra,* pp. 25-26.

Statement.

Prefatory Statement.

While this petition arises from a rate proceeding before the Federal Power Commission (Commission) under the Natural Gas Act with the usual numerous complex issues

involved in such cases, Petitioner here seeks review only of two issues: (1) did Petitioner receive a fair hearing and due process of law under the Administrative Procedure Act; and (2) is the decision of the Court below on rate of return erroneous and in conflict with a decision of the Eighth Circuit.

On September 2, 1948 the Commission instituted an inquiry into the rates and charges of Colorado Interstate Gas Company (Petitioner) pursuant to Section 5(a) of the Natural Gas Act (15 U. S. C. §717d(a)). An order reducing Petitioner's rates on sales for resale of natural gas in interstate commerce in the amount of $3,111,187[1] per year was issued on August 8, 1952.

The Court below affirmed the order of the Commission in all respects save the one which is the subject of the Commission's petition in No. 710.

Factual Statement, Question 1—Omission of Trial Examiner's Decision.

Petitioner contends that it was denied that fairness of hearing and procedure guaranteed by due process of law and the Administrative Procedure Act because the Commission unjustifiably took this rate case from the hearing officer without adequate reason. The basis for the Commission's omission of the Trial Examiner's decision was that the proceedings had been in progress for a long time and, since

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[1] This $3,111,187 was the excess expressly found by the Commission (R. 139). In the petition filed at No. 710 on behalf of the Commission (p. 5) the ordered reduction is stated as being $2,703,000. The Commission had found Petitioner was failing to make its cost of service on one sale in the amount of $380,661 but under the Natural Gas Act could not order an increase. Petitioner subsequently did increase its rates for that service. The Commission's figure of $2,703,000 must result from deducting $380,661 from $3,111,187, which would leave a remainder of $2,730,526. The figure $2,703,000 set forth in the petition in No. 710 must reflect this subtraction and undoubtedly results from an inadvertent transposition of figures.

it lacked authority to award reparations, an immediate decision by the Commission itself was required (R. 66-69). Petitioner objected vigorously to this conclusion (R. 75-77).

While the proceedings here were instituted September 2, 1948, they did not come to hearing until October 1, 1951. Between October 1, 1951 and the conclusion of hearings on April 4, 1952, twenty-two days were devoted to hearings—several recesses being granted, for periods of up to two months, at the request of both Petitioner and the Commission's Staff (R. 67-68).

When hearings began, the Commission held that its Staff had the burden of proving that Petitioner's rates for gas subject to the Commission's rate jurisdiction were excessive (R. 20). The Staff, over Petitioner's objections put in three separate cases-in-chief, comprising five possible sets of data from which, the Staff contended, a rate determination could be made. These studies purported to show that rates were excessive in amounts varying from $1,213,000 to over $3,000,000 (R. 58, 405). The Staff attorney contended that any of these studies, or a combination of them, could be used (R. 216, 252, 331).

Staff attorney's attitude throughout was that Petitioner's rates were excessive, and that the Staff was looking for a rate reduction. This attitude was frequently expressed (R. 58, 59, 219, 226, 285). Petitioner contended that its rates were not excessive (R. 79).

After the close of the hearing record the Staff attorney filed a motion to omit the decision of the Trial Examiner. The grounds for such omission were the unequivocal statements that the proceeding had been pending for a long time and Petitioner was collecting excess revenues which were not subject to reparation (R. 57-59). Petitioner answered that it was entitled to the decision of the Examiner who had presided at all hearing sessions and who could evaluate the weight to be given to the evidence, and that such decision

was a valuable part of the record (R. 57-64). On the day set by the Examiner for the filing of final briefs—and forty-seven days after the Staff motion—the Commission issued its order omitting the Examiner's decision. The ground for such omission was that the proceeding was in progress

> "* * * for a regrettably long period of time, responsibility for which fact is not attributable to any one particular party. In view of the fact that this Commission has no power of reparation with respect to past rates, which may or may not prove to be excessive, it appears that the record in this proceeding presents the kind of situation requiring the omission of the intermediate decision procedure as provided in the Administrative Procedure Act" (R. 68-69).

The Commission then set the matter down for oral argument before it *en banc.*

The authority for the Commission's omission was that in a rule-making proceeding (which, admittedly, this proceeding was) the Administrative Procedure Act provides for by-passing the hearing officer when the Commission "finds upon the record that due and timely execution of its functions imperatively and unavoidably so requires" (§8(a), 5 U. S. C. §1007(a)).

It was Petitioner's contention that the omission of the hearing officer's decision would be highly improper and prejudicial. For instance, when the Staff attorney moved for such omission, Petitioner answered that this Court in *Universal Camera Corporation* v. *National Labor Relations Board,* 340 U. S. 474 (1951) had noted the value of the intermediate decision as a means of evaluating the evidence and is a valuable part of the record. It was pointed out that credibility was an extremely important factor in this case and that there appeared to be a reluctance on the part of Staff witnesses to answer questions and evasiveness in answers citing the record for such purposes (R.

61-62). It was pointed out that the bare record itself indicated such instances.

After the Commission ordered the omission of the Trial Examiner's decision, Petitioner asked that the order be vacated because briefs had already been prepared to the plane of the obvious initial trier of facts, that the issues of fact were sharply drawn, that the proceeding had an accusatory aspect, that no reason appeared nor were findings made determining the necessity for the procedural short-cut, and that elapse of time alone is not ground for avoiding procedural safeguards (R. 75-77). Again, in Petitioner's application for rehearing to the general rate reduction order of the Commission, substantially the same objections were made (R. 157, 180-182).

The written record shows some instances of demeanor of witnesses. For instance, witnesses were not responsive to questions (R. 221); did not know what a witness in a previous case had done, although such knowledge was claimed originally (R. 221-222); would not answer the Examiner's questions (R. 233); and in the treatment of items of cost there was inconsistency with what was done in a previous case (R. 238-239, 240-241, 283-285). In particular, there was one witness who refused to or failed to answer questions (R. 288, 290, 294, 295, 296) and, in fact, this one witness' reluctance was noted on the record by the Trial Examiner.[2]

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[2] The following took place during the course of this one witness' cross-examination (R. 293-294):

"Presiding Examiner: I don't think you have answered the question. The question is susceptible to a yes or no answer. It doesn't have to be limited with that but it certainly should start with that.

"That has been true of about 70 per cent of these questions, lately.

"We have been having an interval of about one minute between question and answer. I think the record probably should show that.

"I don't think the questions are of such subtlety that they cannot be answered yes or no, and then if you wish to explain, you may,

This witness testified to the principal accounting features involved in this rate proceeding and had prepared and testified on the great majority of accounting exhibits and schedules (R. 207, 249, 254, 286, 295, 365-367).

The Court below held on this point that the Commission in its sound discretion could omit the intermediate decision in the instant case and that such discretion was not abused. The Court also concluded that there were no issues of credibility but that rather the question was of the weight to be accorded to the opinions of expert witnesses (R. 594-597).

Judge Bratton of the Court below did not agree with his brethren and stated that omission is "warranted only where the Commission makes a well-founded and sustainable finding that due and timely execution of the functions of the Commission imperatively and unavoidably so requires". Judge Bratton also noted the Commission's lack of reparation authority in all rate proceedings (R. 609-610).

Factual Statement, Question 2—Rate of Return.

The rate of return claimed by Petitioner was 6½%, but that allowed to Petitioner (on its net-investment rate base) was 5¾% (R. 102). This allowance was based upon the

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but I do not think we need to have quite the interval between question and answer.

"I think we will recess at this time for five minutes.

"(Whereupon, at 11:35 a.m. a recess was taken, the hearing reconvening at 11:45 a.m.)

"Presiding Examiner: The hearing will be in order.

"Before we proceed with the case, I would like to ask the witness to be a little less reluctant.

"One of the fundamental bases of the Anglo-American law is that the person presiding evaluate the testimony by reason of the fact that the presiding officer observes the conduct of the witness and the demeanor of the witness. The testimony of Mr. Wiskup during the cross examination has been characterized by great reluctance. Being a staff witness it seems to me that that is not the attitude that one should take and I would appreciate it if he would perhaps try to be a little less reluctant and answer a little more promptly to obviously possible questions that do not involve long analyses of document.

"You may proceed."

cost of capital as determined by the Commission and was derived by taking Petitioner's then total capitalization of $54,914,000 made up of $29,600,000 (53.9%) of long-term debt; $2,000,000 (3.6%) of preferred stock; and $23,314,000 (42.5%) of common equity. The Commission then allowed the historical cost of debt money of 3.21%, 6% on preferred stock and 8.95% on common equity. This 8.95% (8.45% after allowing ½% for cost of financing) resulted from what the Commission designated "an objective study" of investors' appraisal of the common stocks of nine natural-gas companies and statistical ratios for seven other natural-gas companies for back periods up to five years (R. 98-102).

These factors can be stated in a formula as follows:[3]

	% of Total Capitalization	Average Cost Per $	Components of Cost of Total Capital
Long-Term Debt	53.9%	3.21%	1.73%
Preferred Stock	3.6	6.00	.22
Common Stock Equity	42.5	8.95	3.80
	100.00%		5.75%

The Court below affirmed the Commission's finding of a proper rate of return on this basis against Petitioner's contention that this bare cost of money does not give effect to other required factors, such as the ability to attract capital. The Court below would not conclude that there was confiscation (R. 608).

The Court below noted that, while the Commission recited that voluminous rate of return data was before it,

[3] This formula is not expressly stated in the Commission order. It, however, is implicit in the treatment of the subject and results in a precise calculation of the 5¾% used. The formula was expressly set forth by the Commission in an order affecting Northern Natural Gas Company. In *State Corporation Commission of Kansas et al.* v. *Federal Power Commission*, 206 F. 2d 690 (8th Cir. 1953) the finding of rate of return as to Northern Natural was reversed. The Eighth Circuit noted the Commission's express use of such a formula (206 F. 2d at 722).

it was clear that consideration was given only to financial history of nine natural-gas companies whose stock was publicly held, and to seven natural-gas companies whose stock was traded on recognized exchanges, and data on Petitioner's securities, earnings and financial requirements (R. 606).

The attention of the Court (R. 608) was called to *State Corporation Commission of Kansas, et al.* v. *Federal Power Commission,* 206 F. 2d 690 (8th Cir., 1953) wherein, after reviewing pronouncements of the Supreme Court as well as of the Commission itself, it was determined that the formula method of determining a proper rate of return to Northern Natural Gas Company was insufficient. A remand resulted in the *Northern Natural* case.[4] The Court below referred to the Eighth Circuit case as "distinguishable" but did not state any facts in that respect.

The Eighth Circuit opinion noted that in allowing a 5½% return to Northern Natural, the Commission[5] examined the average return of four natural-gas companies, and the average yield of Northern Natural's securities. The Commission also determined that Northern Natural's historical cost of debt money was 2.55%. A formula or equation then was derived as follows:

56% bonds x 2.55% cost of borrowed money=1.43%
44% common equity x 9.25% return on common (including ½% cost of flotation).....=4.07%
5.5%

[4] A conditional cross-petition for certiorari was filed on behalf of the Commission to review this one point upon which the Commission was reversed. See Cross-Petition, No. 469, October Term 1953. This is crossed to No. 382 which is pending on motion for rehearing on denial of certiorari.

[5] The opinion of the Eighth Circuit quotes in full the Commission's opinion on the matter of rate of return (206 F. 2d 690 at 718-719).

The Eighth Circuit then stated:

> "How much weight the Commission ascribed to this equation we cannot know. It is obvious, however, that no rate of return determination can be set out so meagerly and have conclusive value." (206 F. 2d 690 at 722).

That Court then held that from the Commission's findings there could be no "reasoned conclusion" that 5½% return was "just and reasonable". That Court also was affected by four countervailing factors (1) evidence of Northern Natural showing 6% as the minimum; (2) the finding of the Presiding Examiner of 6%; (3) Commission Staff witness' testimony indicating 6%; (4) the fact that there was no evidence indicating a return as low as 5½%.

In the instant case: (1) Petitioner on its evidence showed a minimum of 6½% (R. 98-100; R. 409, 411, 441); (2) there could be no finding by the Presiding Examiner because the Commission by-passed the Examiner; (3) Commission Staff exhibits purporting to show excess revenues were based upon 6%[6] (R. 365, 393, 397, 425, 429); and (4) there was no evidence indicating a return as low as 5¾%.

Reasons for Granting the Writ.

A. The first question—whether the Commission enjoys practically unfettered discretion to omit, over objection, the decision of the Trial Examiner ordinarily required under the Administrative Procedure Act in a hotly contested rate case—brings to this Court for the first time the problem of an administrative agency's authority to omit the intermediate decision in legislative or rule making proceedings.

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[6] The Staff did not indicate a contention for 5¾% return until the briefing stage of the case.

The Administrative Procedure Act was enacted against a backdrop of desire for greater procedural safeguards than had previously been observed. As this Court has pointed out, the legislation represented a long fight to that end and the courts are called upon to give effect to the remedial purposes where the evils aimed at appear. *Wong Yang Sung* v. *McGrath,* 339 U. S. 33, 40-41 (1950).

As to all agencies engaged in rule making functions, the portions of the Administrative Procedure Act, dealing with the ordinarily contemplated procedure of having a Trial Examiner's decision, are of extreme importance. It is important not only to these administrative agencies, but to the parties, and the courts as well since such decision becomes a part of the record in any such proceeding. *Administrative Procedure Act,* §8(b), 5 U. S. C. §1007(b). On appeal, this part of the record is significant, especially where credibility of witnesses is of importance. *Universal Camera Corporation* v. *National Labor Relations Board,* 340 U. S. 474, 496-497 (1951).

The rule-making function of Federal administrative agencies comprehends agency process for the prescription or approval "for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing upon any of the foregoing" (*Administrative Procedure Act,* §2(c), 5 U. S. C. §1001(c)).

The function of rule making, therefore, affects broad economic and business functions. In the field of rate making alone, the question of the procedure required to be followed is of importance under various regulatory statutes—*e. g.,* in the prescription of future rates under the Shipping Act of 1916 (46 U. S. C. §§817-822), the Intercoastal Shipping Act of 1936 (46 U. S. C. §§844 *et seq.*), the Packers

and Stockyards Act (7 U. S. C. §211), the Natural Gas Act (15 U. S. C. §717c and d), the Federal Power Act (16 U. S. C. §824e), Communications Act (47 U. S. C.§§204-205), by the Interstate Commerce Commission on carriage of mail by railroads (39 U. S. C. §542), establishment of joint rail and water rates (49 U. S. C. §6), removal of preference or prejudice arising from intrastate rates (49 U. S. C. §13), establishment of rates for water carriers under Part III of the Interstate Commerce Act (49 U. S. C. §907), establishment of rates for Motor Carriers (49 U. S. C. §316), for Freight Forwarders under Part IV of the Interstate Commerce Act (49 U. S. C. §1006) as well as rate determinations of the Interstate Commerce Commission relating to railroads and oil pipe lines under that Commission's general rate fixing jurisdiction (49 U. S. C. §15).

Congress was very careful, after considerable deliberation, to set forth particular procedural safeguards applicable to administrative proceedings. The Act prescribes procedures to be followed and permits deviation only as particularly set forth. Here, an agency affected by this Act, has presumed to deviate from the procedure generally prescribed by purporting to follow an exception to the general mandate of the Statute. An agency's right so to act should be scrutinized by this Court.

1. Under the Administrative Procedure Act (§8(a), 5 U. S. C. §1007(a)) in a rule making proceeding, a Trial Examiner's decision may be omitted only when the Commission "finds upon the record that due and timely execution of its functions imperatively and unavoidably so requires". The Act also prescribes that agency conclusions in such respect shall be held unlawful if "unsupported by substantial evidence" (§10(e), 5 U. S. C. §1009(e)). On the basis of these statutory requirements, the legally prescribed

procedure is to have the benefit of the Examiner's decision and analysis. The omission is justified under this remedial legislation only where there is substantial evidence that such short-cut is (i) imperative, and (ii) unavoidable to the (iii) due and (iv) timely execution of the Commission's functions. In the case at bar, these prerequisites to omission have not been satisfied.

That the action here was not imperative and unavoidable is clear when it is considered that the case was pending for over three years before it was even brought to hearing, and over three and a half years before the Commission decided upon omission. Of the time elapsing between October 1, 1951 when hearings began and the time when the omission was decided upon, May 26, 1952 (R. 69), only twenty-two days were consumed in hearings and substantial recesses were given to the parties to prepare for differing phases of the case. The Commission expressly stated that delay was the fault of no one.

There was no finding that the Trial Examiner was no longer available for, in fact, he was and still is available.

The justification given by the Commission for its omission was that Petitioner's rates appeared excessive and because a long time had elapsed since the institution of the proceeding in 1948 and because the Commission lacked reparation authority it was necessary to bring the case to a speedy conclusion. Petitioner does not challenge the fact that the case should be speedily concluded, but lapse of time made necessary by the administrative process is no ground for avoiding the requirements of due process. *Ohio Bell Telephone Company* v. *Public Utilities Commission*, 301 U. S. 292, 305 (1937). It is a dangerous doctrine which permits avoidance of procedural safeguards in the absence of extreme public need for dispatch which clearly outweighs the need for the usual process of determination.

As to the lack of reparation authority as a ground for omission, the Commission's position is even more untenable. As pointed out by the Court below (R. 596), the Commission apparently concluded before final determination of the case that in the mind of the Commission there was good reason to believe Petitioner's rates were excessive. It then proceeded on the basis of excusable lapse of time and lack of reparation authority to omit the decision. Determination of the excessiveness of the rates, if any, should be the result of findings made after procedural safeguards had been observed—not a finding preliminary to final decision on the merits.

In attempting to bolster its position by referring to the fact that it had no reparation authority, the Commission runs head-on into the principle that an administrative agency's lack of authority does not grant additional authority. The remedy for lack of authority lies in the agency's ability to address the Congress. *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company,* 337 U. S. 498, 508, 514, 515-516 (1949). As Judge Bratton in the Court below pointed out, the lack of reparation authority cannot be used as an excuse for the omission of the intermediate decision since the Commission has no reparation authority under any circumstances (R. 609). If available as an excuse, the Commission could use such basis as an aid in omitting the intermediate decision in all rate controversies.

The majority of the Court below felt that the Commission could exercise discretion in ordering such omission. But the authority to omit the decision is not purely one of discretion. Omission itself can be justified only if on the record there is substantial evidence to support the required statutory findings.

In the instant case Petitioner at no time requested the omission or waived any procedural right. Instead, it made appropriate objection at the very first opportunity and continued its objections through every possible posture of the case (R. 59-64, 75-77, 157, 180-182). This indisputable fact distinguishes the instant case from the two cases cited by the Court below in support of its affirmance (R. 595). In both cases there was waiver or prior indication of consent of the omission. In the first, (*Kenny* v. *United States,* 103 F. Supp. 971, 978 (D. C., N. J. 1952)), objection to omission was made for the first time upon judicial review. In the second, (*Alabama-Tennessee Natural Gas Company* v. *Federal Power Commission,* 203 F. 2d 494, 497-498 (3rd Cir. 1953)), the company itself had requested omission in a prior allied case involving the same essential issues.

2. The legislative history of the Administrative Procedure Act demonstrates that the intermediate decision was contemplated in situations like the instant case. Both the House and Senate Committees in referring to instances of rule making where there is statutory provision for omission state:

> "However, it may be noted that even in those cases, if issues of fact are sharply controverted or the case or class of cases tends to become accusatory in nature, sound practice would require the agency to adopt the intermediate recommended decision procedure." *Administrative Procedure Act, Legislative History,* 79th Cong., 2nd Sess., Senate Document No. 248, pp. 210, 273.

This legislative history was called to the attention of the Commission (R. 62-63, 76) and was argued to the Court below.

The Court, however, concluded that credibility was not involved because the case really involved inferences to be

drawn from undisputed facts, therefore, omission was proper. Petitioner submits that credibility *vel non* is not the sole test as to whether the intermediate decision is properly omitted. If it cannot be found from the record that the Commission made the requisite statutory findings upon substantial evidence, the omission is unlawful.

Here, however, the facts do demonstrate that credibility was involved. At least as the Court below recognized, there are questions as to the weight to be attached to the evidence (R. 597). In such instances, whether the tenuous line between credibility and weight be drawn, the consequences are the same, since it is necessary to test the validity of agency witnesses' conclusions on the basis of reluctance, confidence in the conclusions, and other matters which do not necessarily appear upon the record but which certainly affect the worthiness of belief. (See Frank, *Law and the Modern Mind*, pp. 109 *et seq.*).

In the instant case, the Commission Staff had the burden of proof (R. 20). This burden was to show by "reliable, probative and substantial evidence" that its conclusions were sound. *Administrative Procedure Act*, §7(c), 5 U. S. C. §1006(c). There was more involved by the Commission than drawing inferences. The Commission made choices of methods put forth by Petitioner and by the Staff dealing with the facts appearing on Petitioner's books. The Commission did not in any instance empirically use a method of its own. Instead, in every instance in which a method was involved, it chose the method of its Staff.[7] Not only were there choices of method involved,

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[7] For instance, in the allocation of certain costs, the Commission chose its Staff's method of allocating costs on a relative value basis never theretofore used by the Commission, and made a deduction of $878,202 from Petitioner's total cost of service made up of $421,537 of allowable expenses plus an income tax credit on account of such deduction in the amount of $456,665 (R. 115, 198).

but the Commission also heeded the conclusions of a Staff witness in eliminating what he concluded were non-recurring items of expense (R. 92-93). The Commission made some minor adjustments to the Staff recommendations, but by and large it accepted its Staff's position.[8]

In the record Staff witnesses were shown to be unresponsive, lacking in knowledge of what had been done previously, and inconsistent. The Examiner, by observing the demeanor of these witnesses, might properly have seen fit to reject their evidence in reaching his conclusions and his conclusions in such regard, under the doctrine of the *Universal Camera* case, *supra,* might well have affected the question of substantiality of the evidence upon which the Commission acted in ordering the rate reduction of more than $3,000,000. It has been recognized that expert opinions may be rejected even if entitled to some weight.

> "This is true of opinion evidence generally, whether addressed to a jury, or to a judge, or to a statutory board." *Dayton Power & Light Company* v. *Public Utilities Commission of Ohio,* 292 U. S. 290 at 299 (1934).

The appearance and demeanor of a witness are "assumed to be in evidence". *Wigmore on Evidence,* 3d ed. §946.

The Eighth Circuit recently had occasion to treat the question of credibility in an administrative proceeding where there had been a change in Trial Examiners. It was held:

> "There remains then the question of whether a credibility evaluation can be said in the present situa-

[8] This is evidenced by the fact that the total cost of service recommended by the Staff was $14,549,902 (R. 80-81), while the Commission allowed a total over-all cost of service of $14,952,567 (R. 115). Petitioner, on the other hand, had claimed a total over-all cost of service of $19,942,871 (R. 80-81).

> tion to constitute a salient element in a sound arriving-at of the controlling facts by an examiner. If, in arriving at some material fact or facts, either as a matter of direct determination or predicated inference, it is necessary to choose, or a choice is undertaken to be made, on a personal basis, between things, which some witnesses assert and other witnesses deny, neither of which is inherently incredible, and such a choice is acceptingly or rejectingly capable of affecting the result, proper credibility evaluation is inescapably involved as a salient processive factor." *Gamble-Skogmo, Inc. et al.* v. *Federal Trade Commission,* 211 F. 2d 106 at 115 (1954).

B. The second question raises the issue on rate of return. An adequate rate of return to a regulated company is a fundamental right and without it there is clear confiscation of property contrary to tenets of due process of law. A regulated company is to be given a rate which will enable it to operate successfully, to maintain its financial integrity, to attract capital and compensate its investors for the risks assumed. *Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591, 605 (1944). If the Commission did not allow such rate of return, its order is confiscatory in its end result and cannot stand. The conclusions of the Commission which were affirmed by the Court below were that Petitioner was entitled to a "bare bones" cost of money. That is, the Commission took the Company's actual capitalization and applied to it the actual cost of debt and preferred stock and an estimated cost of common stock equity. It proceeded on a purely formulistic basis and determined that a 5¾% rate of return was justified.[9] Petitioner submits that such a determination

[9] The Commission's order in this case and in the *Northern Natural* case and another case, all of which came out at substantially the same time, were the subject of considerable criticism in the natural gas industry and by investment analysts (*e.g.*, Badger *"Impact of the Northern Natural Gas Decision on Financing"*,

is in substantial conflict with the previous pronouncements of this Court in regard to what is a proper rate of return. *Federal Power Commission* v. *Hope Natural Gas Company, supra; Panhandle Eastern Pipe Line Company* v. *Federal Power Commission,* 324 U. S. 635, 650 (1945); *Bluefield Water Works & Improvement Company* v. *Public Service Commission,* 262 U. S. 679, 692-693 (1923); *United Railways* v. *West,* 280 U. S. 234, 261-262 (1930). The Commission did not throw into the balance what would enable Petitioner to operate successfully to maintain its financial integrity, to attract capital, and to compensate for risks. The Commission contented itself with the assertion that the rate making process was a continuing one and that if more were required in the future to enable Petitioner to attract capital that the regulatory process was open to accommodate Petitioner in such regard. Petitioner contended that the Commission had to look to the future in its fixing of prospective rates. *McCardle* v. *Indianapolis Water Company,* 272 U. S. 400, 408 (1926); *Missouri ex rel. Southwestern Bell Telephone Company* v. *Public Service Commission,* 262 U. S. 276, 288 (1923).

Beyond the substantial conflict with previous decisions of this Court, the affirmance by the Court below of the Commission's formulistic approach to the determination of rate of return is in direct conflict with the decision affecting the rates fixed by Respondent Commission for Northern

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Public Utilities Fortnightly, Nov. 20, 1952; Badger, "*Fair Return for Natural Gas Companies*", Public Utilities Fortnightly. Dec. 4, 1952; Bickley, "*Utility Regulation by the Stock Market*", Public Utilities Fortnightly, Jan. 1, 1953). Until late 1945 the Commission had allowed an industry-wide standard rate of return of 6½% (*e.g., Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591 (1944)). From 1945 to the Northern Natural order, 6% was allowed (Mississippi River Fuel Corporation, 4 F. P. C. 340, 349-351 (1945)). On the issuance of the Northern Natural order, the return was reduced for the first time below 6% as the "bare-bones" capital costs formula so indicated—probably the lowest return ever allowed a wasting asset business.

Natural Gas Company which was reversed by the Eighth Circuit in so far as the rate of return determination was concerned in *State Corporation Commission of Kansas et al.* v. *Federal Power Commission,* 206 F. 2d 690. The Eighth Circuit reversed because of insufficiency of the Commission's rate of return determination. The fundamental cost-of-capital formula approach of the Commission in both the instant case and the *Northern Natural* case was exactly the same. The Court below noted the fact that the *Northern Natural* determination was called to its attention but declined to discuss the *Northern Natural* reversal beyond the fact of noting that the cases were distinguishable. The Federal Power Commission itself in a conditional cross-petition filed in No. 469, October Term, 1953, relating to the *Northern Natural* determination expressly stated:

> "* * * The decision below conflicts in principle with the decisions of the United States Courts of Appeals for the Tenth and District of Columbia Circuits * * *" (Citing the decision of the Court below, Cross-Petition for Certiorari, No. 469, October Term, 1953, p. 16).

In the cross-petition, the Commission quotes from the opinion of the Court below and then in a footnote (p. 18) states:

> "The Tenth Circuit referred to the opinion below in the instant case [Northern Natural] as 'distinguishable', but without stating in what respect."

There can be no doubt that the Commission considers that the decision of the Court below on rate of return conflicts, in principle at least, with the decision relating to Northern Natural. As Petitioner has pointed out above in its Statement, the factual parallels of the two cases leave no room for doubt that exactly the same type of determination on rate of return was made in both instances.

Considering the fact that the Commission is called upon to exercise expert judgment in making a rate of determination, the reduction of a rate of return to a mere formula does not discharge its duties. As the Eighth Circuit has pointed out, only when the fairness of rate of return has been gauged in the light of risks, conditions of markets, adequate supplies of natural gas and other matters enabling a company to operate successfully, maintain financial integrity, attract capital and compensate for assumed risks can a proper determination be said to have been made (206 F. 2d 690, 720-722). The Eighth Circuit went on to state:

> "In the case under review we are not given any indication that the Commission has so exercised its practical, expert judgment. We are given instead a study that the Commission has made as to the rate of yield of various natural gas companies. We know only from our own search of the record how those yields compare with those of other utilities, and we have no way of knowing how the Commission would rate the risks in the company here under consideration and other companies. In a footnote to its opinion, the Commission sets out the following:
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> | | |
> |---|---|
> | 56% bonds x 2.55% cost of borrowed money.... | 1.43% |
> | 44% common equity x 9.25% return on common (including ½% cost of flotation)..... | 4.07% |
> | | 5.5 % |
>
> How much weight the Commission ascribed to this equation, we cannot know. It is obvious, however, that no rate of return determination can be set out so meagerly and have conclusive value" (206 F. 2d at 722).

In the instant case the Commission did exactly the same thing. It is submitted that in this respect the decision of the Eighth Circuit is in conflict with the Court below in the

instant case and that the decision of the Eighth Circuit reversing the Commission on rate of return was proper. Eleven days after the Eighth Circuit spoke, the Commission corrected its recent cost of money formula rate of return approach in a case involving another natural-gas company.[10]

Conclusion.

For the foregoing reasons, this cross-petition for a writ of certiorari should be granted.

Respectfully submitted,

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May, 1954.

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[10] *In re United Fuel Gas Company*, FPC Opinion No. 258, Commerce Clearing House, Utilities Law Reporter (Federal) 2d ed., par. 9364. In that case the Commission found the historical cost of money to be 6%. The Commission, however, noted that it was its responsibility to allow a rate of return which represents the

> "exercise [of] a fair and intelligent judgment having regard for all relevant facts. This has recently been emphasized in the opinion of the Court of Appeals for the Eighth Circuit, remanding to this Commission for further findings the determination that 5½%, in the circumstances of that case, constituted a fair rate of return for the Northern Natural Gas Company".

The Commission quoted from the *Bluefield* case, *supra*, which requires the exercise of the Commission's judgment. The Commission then allowed to United Fuel Gas Company a 6¼% rate of return.

APPENDIX.

1. The Natural Gas Act, (15 U. S. C. §717 *et seq.*) provides in pertinent part:

* * * * * *

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * * * *

2. The Administrative Procedure Act (5 U. S. C. §1001 *et seq.*) provides in pertinent part:

* * * * * *

SEC. 8. In cases in which the agency has not presided at the reception of the evidence, the officer who presided * * * shall initially decide the case or the agency shall require * * * the entire record to be certified to it for initial decision. Whenever such officers

make the initial decision and in the absence of either an appeal to the agency or review upon motion of the agency within time provided by rule, such decision shall without further proceedings then become the decision of the agency. On appeal from or review of the initial decisions of such officers the agency shall, except as it may limit the issues upon notice or by rule, have all the powers which it would have in making the initial decision. Whenever the agency makes the initial decision without having presided at the reception of the evidence, such officers shall first recommend a decision except that in rule making or determining applications for initial licenses • • • (2) any such procedure may be omitted in any case in which the agency finds upon the record that due and timely execution of its functions imperatively and unavoidably so requires.

• • • • • •

SEC. 10. • • •

(e) SCOPE OF REVIEW. So far as necessary to decision and where presented the reviewing court shall • • • (B) hold unlawful and set aside agency action, findings, and conclusions found to be • • • (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute. • • • In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.